

### Annual Audits

The Division of Local Services encourages communities to have an annual, independent audit performed by a certified public accountant. An [audit](#) is an examination of systems, procedures, programs, and financial data of a community. The objective of an audit is to provide users of financial reports with independent assurance that a community's financial statements are reliable, accurate, and complete. This is especially valuable when going to the bond market. This is because issuers are expected to supply audited financial statements prepared by an independent auditor. Lack of an audited financial report prepared according to [Generally Accepted Accounting Principals \(GAAP\)](#) could have a negative impact on an issuer's rating, since questions about reporting would be raised. More importantly, the audit is an extremely valuable management tool for evaluating the fiscal performance of a community.

A community may be required to conduct an annual audit because it expended federal funds (received directly from the federal government or indirectly through a state agency) and must comply with the [Single Audit Act of 1984](#) (as amended). Other communities conduct audits every two or three years or as resources allow. Unfortunately, audits conducted every two or three years involve more work for the auditor, and more work means more cost to the town. Specifically, when audits are conducted every three years, the auditor cannot rely on the accuracy of the prior year's ending balances, since that year was not formally audited (nor was the year before it). Consequently it takes more time to verify the accuracy of beginning balances, and this additional work is reflected in the auditor's fee.

When selecting an auditor, we recommend that the appointing authority be independent of those who will be the subject of the audit. While members of the financial offices and manager/administrator should be excluded in order to avoid conflicts of interest or any allegations of impropriety, the finance committee (in a town) or the city council (in a city) are good potential candidates. The Division of Local Services encourages the creation of an audit committee. An audit committee should be responsible for the procurement of auditing services, determining in advance the requirements and objectives of the audit and selecting the eventual individual/firm. The committee should have direct contact with the auditor and monitor the audit's progress. Besides the required submission to the Director of Accounts ([MGL Chapter 44 Section 42](#)), the audit report should be sent directly to the audit committee, with copies to the community's officials, to ensure an objective review of the report's findings and conclusions.

An audit generally includes at least three things: a set of financial statements, a management letter, and an opinion. The auditor reviews the financial reports prepared by the community to determine mathematical accuracy and conformity to GAAP, in compliance with [generally accepted government auditing standards](#) (commonly referred to as the *Yellow Book*) published by the Governmental Accountability Office. As a part of the audit, the auditor also reviews the operating procedures of the management process. Any weakness observed or otherwise detected in any operating department is commented on in the management letter.

If an audit management letter reveals improper or inadequate procedures in the municipality's financial management, the problems should be corrected as soon as possible.

The auditor also issues an opinion. In the opinion, the auditor explains what procedures the independent auditor performed, how they were performed, and what was found. An unqualified or "clean" opinion is when the auditor believes that the financial statements are fairly presented in compliance to GAAP standards. A qualified opinion is when the auditor has reservations and an adverse opinion is when the auditor believes the financial statements do not comply with GAAP. During the course of the audit, the auditor also reviews the system of internal controls of a government. If the auditor becomes aware of deficiencies in internal control, often referred to as reportable conditions, these are included in the management letter. If it is found that a community has significant problems or deficiencies, the auditor may express that a "material weakness" exists. A material weakness is a reportable condition of such magnitude that it could potentially result in material misstatements of financial condition.

Community officials and the audit committee should review the report and its findings. For any problem identified, it is advisable that the management team prepares a response. If there is agreement on a finding, the community's management team should formulate a corrective action plan that identifies what actions will be taken, who will be responsible, and when the action will be completed. The audit team, in addition to the management team, should monitor the implementation of the corrective action plan. If there is disagreement on any finding, the management team should provide a thorough explanation for the audit committee to review and decide the best course of action. Effective use of the audit report recommendations can assist the community in improving its financial controls and practices, which may lead to increased public confidence in the government and potential upgrades in a community's bond rating.